Consumer Finance Monitor (Season 6, Episode 52): Community Reinvestment Act Reform: A Close Look at the Final Rule

Speakers: Alan Kaplinsky, Scott Coleman, Sarah Dannecker, and Kenneth Thomas

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services, and what they mean for your business, your customers, and the industry. This is a weekly show, brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the Foreign Practice Group leader for 25 years, and now Senior Counsel of the Consumer Financial Services Group at Ballard Spahr, and I'll be moderating today's program. For those of you who want even more information, don't forget about our blog, ConsumerFinanceMonitor.com. We've hosted our blog since 2011, so there is a lot of relevant industry content there, including a lot of information about the topic we'll be discussing today. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog, or to get on the list for our webinars, please visit us at BallardSpahr.com. And if you like our podcasts, please let us know about that. Leave us a review on Apple Podcasts, Google, or wherever you obtain your podcasts.

Also, please let us know if you have ideas for other topics that we should consider covering, or speakers that we should consider inviting as guests on our show. I'm very excited and pleased to tell our listeners today that very recently, our podcast show was ranked by Good2bSocial as the number one podcast among law firm podcast shows in the United States devoted exclusively to consumer financial services. Good2bSocial is a prominent law firm consulting firm owned by Best Lawyers. We're very gratified by this recognition from one of the country's leading social media consultants for law firms. Today's episode is a repurposing of a webinar that we held on December 6th entitled Community Reinvestment Act Reform: A Discussion on the Final Rule. Okay, before I introduce our speakers today, let me just give you a little bit of background, and this will be very little because our presenters are going to get into much more detail. On October 24th, finally, the Comptroller of the Currency FDIC, and the Federal Reserve Board jointly adopted final amendments to the regulations implementing the CRA.

We're going to provide for you today an explanation of how CRA activities qualify for consideration for credit, where CRA activities are considered, and how they are evaluated. We'll talk about how the final rule impacts financial institutions of all sizes, small, medium, large. The timing for implementation of the final rule, how the final rule differs from the June 3rd, 2022 Notice of Proposed Rulemaking, and how the final rule will be viewed by financial institutions and by community action groups. So let me now introduce our guests and we have, first of all, I want to introduce our very special honored guest. This gentleman, Kenneth Thomas, PhD, joined us for a podcast show on June 23rd, 2022, shortly after the MPR and the notice of proposed rulemaking was published by the regulatory agencies. And he did such a wonderful job on that podcast show that when it came around to organizing the show today, we felt there was nobody better to provide the business insight that is so important and that Ken Thomas is really the guy, the go-to person.

He's the founder and CEO of Community Development Fund Advisors. It goes without saying he's one of the country's leading experts on the CRA. He's testified before Congress, advised regulators about it, has trained federal bank examiners, written numerous articles and two books on the CRA, including the CRA Handbook. Many of the recommendations that he has made have been built into the current CRA regulations. He has launched and acted as chair of the Board of Trustees of two different nationwide CRA investment mutual funds, including the Community Development Fund that was launched in April, 2016. So a very warm welcome to Ken Thomas.

I also want to introduce my two colleagues that will be joining Ken today and will be focused very much on the legal side of what you need to know about the final CRA rule. And I'm pleased to introduce Scott Coleman and Sarah Dannecker. Scott has represented banks and bank holding companies for 30 years in M&A transactions, stock purchase transactions, branch

purchases and sales, capital raising, corporate restructuring, and non-bank acquisitions, changes in bank control, charter conversions, et cetera, et cetera. He is also, needless to say, an expert on the Community Reinvestment Act and not only that, an expert on what I would call the many CRA acts that exist that have been enacted by states, that have existed for several years because they cannot be ignored either.

And I also want to introduce Sarah Dannecker. Sarah is in our Business and Transactions department. She also does a lot of work with Scott and focuses very much on bank regulatory matters. And she also has, since she's joined us, has become very well versed on the CRA. So let me just give you a brief overview of how we're going to proceed. I'm going to, in a moment turn it over to Scott Coleman, who is going to provide some more detailed background about the final rule, and then Ken will chime in on that. Then we will turn to assessment areas and we'll start with Sarah, and then Ken will also provide some insight about that. Then we will get to the CRA tests. That will be Scott, then Intermediate and Small Bank's performance evaluation, both Sarah and Scott. Then the strategic plan, Sarah, data collection, Sarah, and commentary on the final rule, and that will be Ken. So make sure you stay tuned for the duration of this webinar. So with those introductory remarks, I'd now like to turn the program over to Scott.

Scott Coleman:

Thank you, Alan. So to start with just a little background, what has happened today, as a reminder, in 1977 Congress passed the Community Reinvestment Act to encourage regulated financial institutions to help meet the credit needs of local communities as well as deposit needs. Specifically, institutions were to put back money into the communities in which they were accepting deposits. The Community Reinvestment Act is often associated with fair lending and the various fair lending statutes and regulations. It has been in existence consistently since that time. Its first comprehensive revision was in 1995. More recently, things got a little bit unusual. In 2017, the OCC issued a advanced notice of proposed rulemaking. Then there was a notice of proposed rulemaking that suggested that the FDIC and OCC were together looking at CRA modernization and reform, but the FED was not participating in that process. Finally, in 2020, the OCC issued its final rule, which neither the Board of Governors of the Federal Reserve system or the FDIC joined in. That rule was subsequently withdrawn.

And we had, as Alan mentioned, the 2022, May 2022 Notice of Proposed Rulemaking, and then silence until October when the final rule was enacted. So realistically, if we trace back to the OCC's advanced Notice of Proposed Rulemaking, we're talking about at least six years of work on this, and we'll talk about how the regulators did and whether they accomplished their objectives. It was believed that reforms were needed, primarily to better respond to inequities in credit access, and to reflect advances in technology, including the expanded role of mobile and online banking, which enabled primarily large institutions, but actually all institutions to reach outside their facility-based assessment area to generate deposits. I'll now pause and ask Ken to tell us why CRA is more important today than it ever was.

Ken Thomas:

Thank you very much. Well, first I want to thank you and especially Alan for this Consumer Finance Monitor. I could not think of a better time to have this kind of a podcast now, not just because of the CRA final rule, but because of what's happening with Fair Lending. I just came a few weeks ago from Austin where we had the Colloquium ,and we had various speakers there, Kristen Clarke from DOJ, who took over for my friend John Seward who did an outstanding job there in fair lending. And they've got a dozen cases already done, two dozen more at least, we're going to see a lot in the south for sure based upon the Southern Project done by the CFPB. But the bottom line is, we have to look at CRA and fair lending together, and it's never been tougher. Actually, the toughest was in the early 90s after the CRA reform first came out.

But I could tell you, this final rule, and I've been in banking and I've taught banking 50 years. This is without a doubt the final rule, the most complex and challenging regulation that banks have ever faced in this country. I'm talking about all capital, liquidity, BSA, every rule, nothing comes close to this, not just in 1,500 pages, but in complexity. Even a Wharton PhD has trouble figuring this thing out, believe me. And the implications of it, I would say first, there are clearly unintended consequences that will hurt banks, that will hurt communities, our distressed communities, but then there's intended consequences, namely the ratcheting up of failing banks from just over 1% to over 10%.

Look at page 76, table 33 in the final rule, 10.3% of banks will fail the retail lending test. And you know what that means. 34% low satisfactory. This is unprecedented, this level of enforcement, and again, I cannot think of a better time than to have this

discussion now. And so with that introductory remark, I want to turn it back over to Scott and the team, and again, I will come back on later, but this is really very, very important that we have this discussion now. Thank you Scott.

Scott Coleman:

And I will ask Sarah to talk about what the final rule says regarding assessment areas.

Sarah Dannecker:

Yes, thank you, Scott. All right, I am going to chat today about the assessment areas under the final rule, starting with facility-based assessment areas which the agencies are going to use to evaluate the bank's record of meeting credit needs in the communities that they serve. The idea really being that the bank's facilities remain an essential way of defining local communities. So under the final rule, this is going to include each county where a bank's main office branches and deposit-taking remote service facilities are located. It's also going to include the surrounding counties where the bank originated a substantial portion of its loans, so mortgage loans, multifamily loans, et cetera, et cetera. The final rule does not require banks to delineate facility-based assessment areas based on the location of any other staffed bank facility that accepts deposits. It also does not require banks to delineate facility-based assessment areas based solely on the location of its loan production offices.

So instead, the geographic area where those offices are located may be delineated as a retail lending assessment area, which I will discuss shortly here, or in the outside retail lending area. In terms of the geographic requirements, these areas are going to consist of a single metropolitan statistical area, one or more contiguous counties within the MSA, or one or more contiguous counties within the non-metropolitan area of a state. And then consistent with the current CRA rule and the current agency guidance that's out there, the banks may not delineate facility-based assessment areas extending beyond an MSA boundary or beyond a state boundary unless it is in a multi-state MSA. So regarding the geographical requirements for large banks, they must delineate whole county facility-based assessment areas. Intermediate and small banks on the other hand, may continue as they currently do to include partial counties so they can adjust the boundaries to include a portion of the county that it can reasonably be expected to serve. And partial counties must consist of contiguous whole census tracts.

Moving on to the retail lending assessment areas. So these are going to be used to evaluate a large bank's closed-end home mortgage lending and small business lending performances. For the purposes of the retail lending test, which Scott will discuss a little bit later on. This assessment area is only going to apply to large banks that meet certain minimum loan reporting thresholds within their retail lending assessment area. So that's going to be banks that have originated at least 150 closed-end home mortgage loans or at least 400 small business loans in each of the prior two calendar years. So if that threshold is met, then the large bank is going to need to delineate for a particular calendar year a retail lending assessment area. Do want to note that large banks that originated or purchased more than 80% of its qualifying loans, so for mortgage loans, small farm loans, et cetera, more than 80% of those within their facility-based assessment area, they do not need to delineate this retail lending assessment area for a particular calendar year.

Geographic requirements, this retail lending assessment area is going to consist of either the entirety of a single MSA or all counties in the non-metropolitan area of a state. And then lastly, I want to touch on the outside retail lending areas. So these are going to be applicable to intermediate banks, small banks that opt into the retail lending test, or large banks that originated or purchased loans in any product lines in the outside retail lending area during the evaluation period. And so the thresholds for applicability, again, are going to be banks that voluntarily opt into it or if in the prior two calendar years the bank originated or purchased outside of its facility-based assessment area, more than 50% of the bank's home mortgage loans, multifamily loans, small business loans, small farm loans and auto loans if those auto loans are part of the bank's product lines.

In terms of the geographic requirements for outside retail lending areas, it's going to be two components. There's going to be a general area, which is the nationwide area, but which excludes facility-based assessment areas, retail lending assessment areas, and then any county in a non-metropolitan area where the bank did not originate or purchase certain loans. It's also going to comprise component areas, so any MSA or non-metropolitan area of any state included within the outside retail lending area. So with that being said, I will turn it over now to Ken to provide his comments on these assessment areas under the final rule.

Ken Thomas:

Thank you very much, Sarah. That was a very good summary of those rules and let me just start off by saying the concept of retail lending assessment areas in ORLA. If you go to table thirty-six on page six 80 of the final rule, you'll see that 23% of banks will fail the on our retail lending assessment area, 29% will fail on the ORLAs. Why come up with something that 25 to 30% of banks are going to fail? What does that tell you about the regulators, their mindset? The bottom line is this whole concept of the retail lending assessment area is totally backwards and totally wrong. I will tell you that the OCC had it right back in June 2020 with the final rule when they had deposit-based assessment areas with the 5% reinvestment rule. What that rule said was very simple. If you take more than 5% of your deposits from a market, you will now be required to put some amount of benefits, CRA benefits back in. Right now, all of the benefits from the branchless banks go where? They go to three states, Utah, Delaware, and South Dakota.

Why? Because the branchless banks don't have any CRA requirement for deposit base. Now, why is this important? I once asked Senator Proxmire, and as Scott mentioned, I'd worked on the 95 rules and I knew him. I said, "Why did you call it the Community Reinvestment Act? Why not Anti-Redlining Act? That's what Gail Cincotta came up with in Chicago." He said, "Ken, the goal is very simple. We insure deposits at banks, and we want to make sure that when they take them out of a community, there's a requirement to lend back into it, not all of it, but to meet the credit needs in a safe and sound manner, period. It's about reinvesting deposits. That's the middle name of CRA, reinvestment." Now, why did they come up with lending? I believe personally it was political. And CRA has never been politicized as it is now. When Harden and Mnuchin came in under Trump, they came in with some issues you might recall from OneWest that they went after CRA.

The biggest issue at the banks at the time, and I've been on the board of a bank for over 20 years, I could tell you was at the time, not CRA, it was BSA. And then they decided to come out with it as Scott mentioned all the background, and then when Biden got in, he had favored people at the Fed, and we know who these are. She's now at the White House working there. She was the architect behind this. They put together this September, 2020 ANPR at the Fed, which is very, very similar, strikingly similar to the final rule we got. The bottom line is, this is a Fed rule, not really interagency. Now why is that important? Because when they came out with it, they wanted to do everything opposite that Trump had done. And so they said, "Well, instead of deposit-based assessment areas, what's the opposite of a deposit in banking? Well, it's a loan. Deposits are our input, loans are our output."

So we'll do lending assessment areas, and what that did, immediately was to safe harbor the branchless banks, the internet, the fintech, the credit card banks, when you safe harbor these banks, they are sucking deposits, in my estimation, about two trillion of deposits come out from credit card banks out of our big cities mainly. This is about 10% of the roughly 18 trillion of deposits nationwide. Now, if you use simple rules based upon analysis I've done at the Sierra Handbook, I've concluded that those banks, these credit card banks, the internet, the big fintechs, they would have about 40 billion of CRA benefits attributed to the amount of deposits that they accumulate. Where's that 40 billion going? To those three big markets. I once heard the mayor of Wilmington talk about CRA, how it rebuilt our city our downtown.

"I don't even know what CRA stands for," he said, but the point is, 100% of the benefits go to those three states, where they should be going to where the deposits come from, our big cities. New York market for example, contributes in my estimation about 10%. They are missing out on 4 billion of CRA benefits annually. Can you think of a big city in our country that needs help more than New York? 10% comes from Houston, Dallas, L.A. And so forth. Our big cities are being weblined, not redlined, weblined by the Federal Reserve under this new rule, and again, they are safe harboring these branchless banks with this RLAA concept. I'll leave you with this final comment. When we established CRA back in '77, the goal was to obviously meet community credit needs. Who opposed it back then? It was Arthur Burns at the Federal Reserve. And who opposed it?

Because they were saying what? It was credit allocation. It was not the industry that opposed it was the Federal Reserve that opposed this in '77 when we established the law. They said it was credit allocation. And then when we did the rewrites, I worked with Jim Hardwick at the Comptroller's office and they did a great job, but we had a proposal come out in '93, the Fed fought it, '94, you remember Larry Lindsey fought it, throw it in the fireplace, finally they agreed on it in '95. Well, that rule worked fine. Senator Proxmire liked the current regs, they work fine. And they've been working fine, $500 billion going into our communities. But the problem is with this new one, we are now really allocating, and I call it the Credit Reallocation Act. Because this is real credit allocation. Why? Let's go back to banking. Okay, you open up a branch, you put deposits, you take

out deposits in a market, you put it back. Now you don't have to put it all back. We look at, remember host loan, the deposit ratio and the Interstate Banking Act.

You do at least 50% loan to deposit, maybe you do 80% for high sat outstanding. So what do you do with the rest of those loans? You can lend them wherever you want. If you want to lend them to crypto, you want to lend them do marijuana, you want to lend them to condos on Miami Beach, that's up to you. This is capitalism. This is what we preach at Wharton, capitalism. And if you make bad loans, you will pay for it at your bank, you will lose your job, your stock price will go down. We don't want the government, the Federal Reserve telling banks where they should lend.

And now, it's not just where you're lending in your local market. We're now looking, as Sarah said, to your retail lending assessment area and your ORLA nationwide. They are looking at every single loan we make. That is real credit allocation. How ironic that the same Federal Reserve that opposed this in '77, calling this credit allocation, now they come around and the result with this credit reallocation. Again, enough of my lecture here, I'm going to turn it back to the group to talk about where we are and I'll continue my commentary later. Thank you.

Scott Coleman:

Thank you, Ken. I do think it is worth focusing on this just a little more because if we think about what modernization was necessary, if we were going to say loans should be put back in the communities where deposits come from, this completely misses the mark, right? Now, they can just make their retail lending areas wherever they want. They can get the deposits from one place, sourcing them through the internet using technology, and not putting them back in those local communities, serving low to moderate income borrowers in those communities, but taking them somewhere else, to your point, potentially to three states. And that is a real problem with the rule. There's no question about it. We've had a number of questions come in, especially about outside retail lending areas. We will probably not, given what we're trying to accomplish here, walking through the entirety of the rule, be able to address all of them today. One comment we received, I'll call attention to was that supposedly each large bank should have one outside retail lending assessment area, not multiple.

That said, I'm going to attempt to talk about the CRA tests. I'm going to cover them at a fairly high level, and try not to get too bogged down in the details. If there's interest, we're certainly willing to touch on things in more detail at a subsequent time. I think as a level set, we should talk about the asset size thresholds. I'm sure most people are familiar with those, but remember that under the final rule, small banks are those banks with total assets of less than 600 million. Intermediate banks are those with total assets of at least 600 million up to 2 billion. And any institution with 2 billion in total assets or more will be designated a large bank for CRA compliance. So now I'm going to talk about the CRA tests. Depending on what type of institution you are, if you're a large bank or an intermediate bank, you will be evaluated under the retail lending test. That test is optional for small banks. Small banks can maintain the current test if they so choose. There will also be a retail lending services test.

And then for large banks, there's both a community development financing test. That test is optional for intermediate banks. They can continue to be assessed under the current community development test. And finally, the fourth test is a community development services test. The retail lending test then evaluates how large banks are serving low to moderate income borrowers, small businesses and small farms in their various assessment areas. As Sarah mentioned, we have facility-based assessment areas, retail lending assessment areas, and ORLAs. And so we will look at the retail lending tests for all of those. Those include home mortgage loans, multifamily loans, small business loans. They also include small farm loans and certain automobile loans. I'll talk more about that in a little bit. The retail lending test applies two sets of metrics in evaluating CRA performance under the test, the retail lending volume screen and the geographic bank and borrower metrics.

A couple notes as well that the test does consider purchase originated and purchase loans. The test can also consider loans made by an affiliate if the data is provided. That allows them to analyze those loans and provided that that affiliate is also not counting those loans for CRA purposes. So for an institution that might have an affiliate that does residential mortgage originations, those residential mortgage originations, if the affiliate is not subject to a separate CRA examination, could be counted. Now the regulation, they will examine lending activity based on geographic dispersion. That's the proportion of lending, the dispersion of lending and the number of loans in LMI areas. And they'll look at borrower characteristics for home mortgage loans, small business and farm loans and consumer loans as applicable. The retail lending volume screen is created

by looking at the large bank's volume metric compared to the aggregate ratio of retail lending deposits among all banks that operate a branch in a facility-based assessment area.

So there's a market volume benchmark based on deposits of all banks in the market, and if a large bank's bank volume metric meets or exceeds 30% of the market volume benchmark, then examiners would proceed to evaluate the distribution of the bank's retail lending in that area. If it falls short of the retail lending volume threshold, examiners would perform a detailed review of the bank's performance to determine whether the bank has an acceptable basis for not meeting the threshold. If there is no acceptable basis for not meeting the threshold, an institution for that area will receive a conclusion of needs to approve or substantial noncompliance. Moving on to geographic bank and borrower bank metrics for facility-based assessment areas, large banks will be evaluated based on geographic and borrower distributions of its major product lines in its retail lending test areas. And in a facility-based assessment area, the major project lines will include retail loans, that is originated and purchased, closed-end, home mortgage loans, small business loans, small farm loans, and potentially automobile loans.

It will also include loans that individually comprise 15% or more of the dollar amount of all the bank's retail loans in that facility-based assessment area. Continuing then, originated and purchased closed-end home mortgage loans or small business loans qualify as a major product line in an area if the large bank originated the amount required under the loan count threshold. Let's talk about how do the evaluations work under the retail lending test. Once a large bank's major product lines are established, the examiners will evaluate the geographic and borrower distributions of each of those lines in the four separate lending categories in each retail lending test area. They'll look at low-income census tracts, moderate-income census tracts, low-income borrowers or businesses or farms with gross annual revenues of less than $250,000, and moderate-income borrowers or businesses or farms with gross annual revenues of greater than $250,000, but less than and equal to a million. Metrics will be compared to market benchmarks and community benchmarks.

One of the problems of course with trying to plan for, and Ken will talk about planning for the new rule is no one knows the data right now to evaluate the benchmarks. You don't know what lending is being done by competitors in a given area, and probably have to do some data crunching and analysis and new reporting to figure out your own lending in these facility-based assessment areas, retail lending assessment areas and ORLAs. So there is a challenge ahead of us for sure in trying to generate compliance. I'd like to talk now briefly about the conclusions and product line scores that will be generated. Based on the metrics, benchmarks, and thresholds that we just described, large banks will receive a score for each major product line by assessment area. Examiners will average the geographic and borrower distribution averages to assign a product line score. The product line scores are then combined to produce a recommended conclusion for retail lending test area.

The major product lines are weighted based on a combination of loan dollars and loan count in the product line, and the resulting retail lending test recommended conclusion serves as a basis for the retail lending test conclusion in the particular retail lending test area, subject to certain additional factors that the regulators can consider. Each test area's conclusion will be weighted using a combination of the percentage of the large bank's product line loans in the area, and the deposits in the area. Editorially I would also mention that if the goal was to simplify CRA compliance, complying with the retail lending test, they have not accomplished that goal. It's a very complex set of calculations, and that's just one of the four tests. The retail services and products test then is applied to large banks with assets over 10 billion based on branch availability, remote service, facility availability, and digital and other delivery systems.

For large banks with assets of 10 billion or less that have branches, they'll only be required to be evaluated on branch availability and remote service availability. Large banks with assets of 10 billion that do not have branches will be evaluated only on digital and other delivery systems. And the retail services and products test is assessed at the facility-based assessment area, the state, the multi-state MSA, and the institution levels. So that's test two of four. Test three is community development, and I think community development is the one thing that from my perspective, and Ken is free to disagree that the rule got right. This does provide clarity to institutions from a compliance perspective, and allows for innovation and for institutions to seek additional guidance. The rule introduces 11 community development categories, and provides that the agencies will issue illustrative lists of community development activities, and there will be a process by which banks can seek confirmation from their relevant primary regulator, whether a particular loan investment or service is eligible for community development consideration to provide additional clarity regarding loans, investments and services that support community development.

The community development categories, there are 11 of them, include affordable housing, economic development, community support services, revitalization or stabilization activities, provision of essential community facilities, provision of essential community infrastructure, recovery activities that promote recovery within a designated disaster area, investment and financing that promotes disaster preparedness and weather resiliency, qualifying activities in native land areas, activities with minority depository institutions, women-owned depository institutions, low-income credit unions and community development financial institutions, and financial literacy. The community development financing test evaluates how well a bank meets the community development financing needs in each facility-based assessment area, each state or multi-state metropolitan statistical area. It adopts a qualitative approach that includes standardized metrics and benchmarks that examiners will use to evaluate a large bank's community development loans and investments. Once again, benchmarks are not readily apparent and will need to be developed, which creates an information vacuum at this time.

Unlike the current approach where the agency separately evaluate a large bank's community development loans and investments under the current lending and investment test, the community development financing test evaluates community development loans and investments together, relative to deposits. And metrics are evaluated against benchmarks such as community development financing activities by other banks. In addition to the community development financing test, there's also the community development services test. Under the services test, examiners will qualitatively evaluate a large bank's record of helping meet the community development needs of and the impact and responsiveness of those services in the bank's facility-based assessment areas, state multi-state MSA and nationwide areas.

The final rule amends the current definition of community development services to identify the individuals who must perform such activities, primarily the bank's board members and employees, and includes activities that consider the areas of expertise of bank employees such as human resources, information technology, legal services. So it wouldn't necessarily be the case for example, that home building or other community volunteer activities would necessarily qualify under the community development services test.

Real quickly, before I talk about intermediate banks, I just want to hit a little bit on how the ratings work. And just as a reminder, banks are evaluated for lending, investment and services, and in those areas get assigned ratings for performance in one of five categories. Outstanding, high satisfactory, low satisfactory, needs to approve, or substantial non-compliance. And we've talked about already the ramifications of that, and we've got these four tests for large banks, and they're weighted. So the retail lending test is weighted at 40% for composites area rating purposes. That's reduced from the proposed rule of 45%. Retail services and products are weighted at 10%. So if you take retail lending at 40, retail services and products at 10, there is half of your CRA rating.

Then on the community development side, if you take community development financing, in the proposed rule, it was weighted at 30%. It is now weighted at 40%, so that's an increase. And community development services test is weighted as 10% as was in the proposed rule. So retail lending is 50%, community development financing and services together are the other 50%, and that's important to keep in mind.

So intermediate banks as we talked about are those institutions with total assets of at least 600 million, but less than two billion. They are evaluated under the retail lending test I just described, and a community development test. And as mentioned, they get the option, they can choose the current community development test under the existing rule, or the new community development financing test. And they do not have the services tests, although they have the ability to opt into those. And Sarah, I'll turn it over to you to talk about small banks.

Sarah Dannecker:

Thanks, Scott. All right, I am going to chat now about the small bank performance evaluation under the final rule. So the final rule is kind of reclassified banks. So banks with assets of less than 600 million as of the year-end, in either of the two prior calendar years are now going to be classified as small banks. And the proposed rule noted that the agencies estimated that approximately or a little under 800 banks currently classified as intermediate small banks will now be reclassified as small banks under the final rule. So the two tests the small banks are going to be subject to are the small bank lending test and the retail lending test. The small bank lending test, the final rule really maintains the criteria from the current CRA regulations to evaluate the small bank's lending performance.

So again, they're going to continue to be evaluated based on their loan deposit ratios, the percentage of the loans in other retail and community development lending activities they're engaged in, it's record of lending to borrowers and businesses, farms of differing income levels and sizes, it's geographic loan distributions, and then it's record of responding to complaints regarding where warranted its performance meeting credit needs.

Small banks under the final rule may also request additional consideration for criteria under some of the other tests like the retail services and products tests or the two community development tests. So for things like their community development investment and services activities or for providing branches and services or digital delivery systems and deposit products that are responsive to certain low and moderate income individuals or groups or businesses. And then again, as I've noted, small banks may opt to instead of being evaluated under the small bank lending test, be evaluated under the new retail lending test under the final rule. So for small banks that do choose to be evaluated under this test, they will be evaluated using the same criteria that is used to evaluate intermediate banks. So the same criteria that Scott just discussed, which again is the geographic and borrower distributions of the small bank's major product lines being evaluated in its facility-based assessment areas, and then where applicable in its outside retail lending areas and then compare it against market and community benchmarks.

I'm going to talk briefly now about the strategic plan under the final rule. So this still remains an alternative method for evaluation for banks that conduct a significant volume of activities outside of their assessment areas or that operate under a business model outside the scope of the performance tests. Banks with multiple assessment areas may continue to prepare either a single plan or separate plans for their facility-based assessment areas, their retail lending assessment areas, ORLAs or state multi-state MSA or institution levels. In terms of changes from the current CRA rule, so the term of the plan itself, they've retained the five-year term limit, but they have eliminated the current requirement for multi-year plans to include annual interim measurable goals. Other changes, any geographic areas, so facility-based assessment areas, ORLAs, retail lending assessment areas that are not included in an approved plan but would be evaluated in the absence of a plan will be evaluated under the applicable performance test.

So for example, a large bank that has one facility-based assessment area and two retail lending assessment areas could have an approved strategic plan for the facility-based assessment area, but then the two retail lending assessment areas would be evaluated under the retail lending test. In terms of plan content, the plans are going to need to specify the justification for pursuing the strategic plan option. So specifying how many of the bank's activities are outside the scope of an otherwise applicable performance test. Why being evaluated pursuant to a plan is a more appropriate means and you're going to need to include the justification for each aspect of the plan. And the final rule provides elements required for each justification. Bank subsidiary activities must be included in the bank's plans unless that operating subsidiary is independently subject to the CRA. However, bank affiliates activities may be included in the plan if that affiliate is not already included in the CRA performance of another bank. And affiliated banks can develop joint plans. And then conclusions and a ratings methodology are going to need to be included in the plan.

All banks other than small banks with no community development requirements under the final rule must include the applicable community development test in their plan. Really quickly, some of the other changes from the current CRA rule, the formal public comment period has been changed from 30 days to 60 days, and banks are going to be required to post the initial draft plan on the Federal Supervisory Agency's website as well as their website, as well as publishing in at least one newspaper of general circulation in each of the facility-based assessment areas. And that is going to be regardless of whether the bank has a website or not.

And then finally, the means for submitting comments electronically need to be provided. I will chat now about the alternative weighting. So this may be used when combining borrower and geographic distribution analysis. So an intermediate bank, for example, under the retail lending test may be able to adjust weighting to account for the say, lack of economic diversity in a geographic area that makes up its assessment area. For geographical weighting, banks may specify alternative weights for averaging test performance across assessment areas or other geographical areas based on their level of activity and capacity in specific geographic areas. And then banks can also propose alternative weighting methods for combining performance tests to develop ratings in states, multi-state MSAs and for the institution. In terms of approval, timing, the final rule has changed it from 60 days to 90 days and plans are no longer automatically approved if not acted upon by the agencies within the approval timeframe. So you're either going to get a decision or the agencies will communicate the rationale for the delay and then the expected timeframe for a decision on the plan.

I've included here a slide on draft plan evaluation criteria. So I've listed those out there. They really do follow the different tests under the CRA. So the extent and breadth of retail lending or retail lending related activities goes to the retail lending test. The effectiveness of the bank systems goes to the retail services and products tests, and then the other two are going to the community development activities. Mandatory plan amendments. So when banks will be required to amend their strategic plan versus when they may optionally amend it, the final rule outlines the requirements for that. So it's when a material change in circumstances impedes the ability of a bank to substantially meet its approved plan goals or if a material change in circumstances significantly increases the bank's financial capacity and ability to engage in retail lending. So this would be, say through a merger. Then banks will be required to amend their strategic plan.

One thing I will note just from reading the comments to the final rule, the agencies did note that although it's not what they contemplated in the proposed or the final rule, they did note that an amendment to an approved plan may be necessary where there are facility-based assessment area changes. So if a bank adds an assessment area, a new one that maybe includes a branch that opened in a new MSA where it hadn't previously had a presence before, the plan may need to be amended or when facility-based assessment areas are added or changed significantly during the term of the approved plan and the plan does not already contemplate how that area will be evaluated in that instance. So in terms of retail lending assessment areas, if a retail lending assessment area isn't required at the time a plan is approved but then is later established during the plan term, a bank will not be required to amend the existing plan and the large bank will not be evaluated in that area.

And then for any retail lending assessment areas identified in a plan but that are no longer required because the minimum loan reporting thresholds are not met, the agencies will not review performance in that area for the applicable year that the thresholds were not met. And then finally, performance evaluation under the plan. The only thing that I'll really add to that to what's on the slide is that the final rule is really reflecting that a bank's performance is no longer based exclusively on the approved goals. It's now based on applicable performance tests, optional evaluation components if there are any, and then eligible modifications in additions to the plan. So while goals will still be considered, they will just be considered in conjunction with the performance tests.

All right, moving on now quickly to the reporting data. Here the changes are mainly going to impact large banks. Intermediate banks will have some changes if they're opting into the community development financing test, and there's no real changes to the small bank reporting requirements. So the information to be collected and maintained are going to be small business and small farm loans. In terms of consumer loan data, automobile loans, intermediate home mortgage loans, data collected needs to be collected on that. So what I will say about home mortgage loans is that large banks that are subject to the CFPB's Reg C, the Home Mortgage Disclosure Act must collect information about their home mortgage loans, origination or purchase outside of the MSAs in which it has a home or branch office. But those banks that are not subject to Reg C due to the location of their branches but would otherwise meet the size and lending activity requirements under Reg C, must collect and maintain certain data for each closed-end home mortgage loan that was originated or purchased during the evaluation period.

In terms of retail banking services and retail banking products data, so large banks must collect location information for its branches, main offices and remote services facilities, things like openings and closings, hours of operations, services offered at each branch, and then for large banks with assets that are greater than 10 billion as of December 31st in both of the prior two calendar years, or large banks with assets of less than or equal to 10 billion as of December 31st in either of the prior two calendar years that do not have any branches or a main office, or then large banks with assets of less than or equal to 10 billion in either of the two prior calendar years that request consideration for its digital delivery systems, they're going to need to collect certain information about their retail banking services and products. So the types of services and products offered through their digital delivery systems like your online banking and mobile banking products, other delivery systems and things like that, the systems and activity of those digital delivery systems by income levels, so low, moderate, middle or upper, or individuals, families or households.

Additionally, there's going to be data collection and maintenance requirements for community development, loans and investments data, community development services data. And then finally, certain large banks are going to be required to collect deposits data. So large banks with assets greater than 10 billion as of December 31st in both the prior two calendar years must collect the dollar amount of its deposits at the county level based on deposit location. Information that's going to be required to be reported. Small business and small farm loan data for large banks. Then community development loans and investments data and deposits data. Banks are now are going to be required to collect data on their operating subsidiaries to

the extent that that subsidiary engages in retail banking services, products and community development lending or investments or community development services.

And then finally, assessment area data. So banks are going to be required to collect and report a list of each facility-based assessment area, and then large banks are going to be required to collect and report a list of each retail lending assessment area showing the state's MSAs and counties for the prior calendar year. All right, I will turn it now over to Ken for some commentary on the final rule.

Ken Thomas:

Thank you, Sarah. So first slide here of the four, misconceptions. Okay, so why are banks under 600 million being safe harbored? Why did they do that? Well, the Fed did that very simply to get more political sway. They figured by bringing in more banks, we now go to 600 million. What does that do? That's two thirds of all banks. They figure that'll help them get the rule through, but you're not exempt. Why? Because the same examiners who are doing small banks also will be doing intermediate and large. Those say, okay, well under the new regs, you have four or 500 million, and remember, I've been a banker for over 20 years as a director, they're going to say, "Guess what? Under the new rules, you would be needs to improve. But under the current one, you're going to get satisfactory." They're going to let you know that and that's going to sway their opinion.

They're the same examiners. So we're now a new intermediate bank between 600 and two billion. You've got the retail lending test to deal with. Also, of course ORLA, but the retail lending test is a real killer. You saw what the percentages are going to be. Now, we have had outstanding ratings in the past, and we should continue to get that rating again. No way. Ratings for outstanding are going to be very, very rare. Notice in the NPR on table nine, page 251, they had a table there that of the banks over 50 billion, there are about 50 of them, none of them will get outstanding. Now think about that. Those are the banks, the big banks that really move the needle in our distressed communities. None of them will get outstanding. What's the point? If you're going to come to a class and nobody's going to get an A, even though I'm the best teacher, it doesn't matter. Nobody's going to come because you're not going to get an A. What's that going to do to motivation? It makes no sense at all. Outstanding ratings are going to be very hard to get.

The strategic plan option, not as simple as it used to be, because you have to now explain why you should be strategic plan and you have to give a good explanation as Sarah just said. And finally, well, we don't have to worry about this until 2026. No, we've got to deal with them right now. Why? If we go to the next slide, what do we need to do right now? Most importantly, we have to understand the rule, be able to explain to our board what the new rule means. Could we be liable for some fair lending case? Look at the case in Rhode Island. Will we be next? Most importantly, and if I leave you with one point, this is it. If you have an exam in '24 or '25, do everything possible to get outstanding. Now, so many bankers say, "Oh, Ken, we don't want to be outstanding. There's only one way to go. We want to blend in with the 90% of satisfactory banks. When we're outstanding, all the community groups come calling for money."

No. This will be your last chance to get an outstanding rating. Now, probably too late maybe for lending, maybe not for services, but under the investment test, whether you're ISB for the community development test or large bank investment tests, you can still buy investments. And under the current regs, you could buy them up to the last date and get full credit for the review period. That will change under the new regs. Do everything you can to get outstanding, and what does that usually mean? A lot more investments. And we have a template, I won't go into it, but they are like 12 determinants as to how much is enough. The baseline from the CRA handbook is 1% of average assets, 1% of average assets for outstanding. Think about that.

Finally, there are a lot of other webinars. Make sure you're on top of all of them. What are the main takeaways? Well, the good news is is that all banks listening here will get credit for this presentation. Why? Because as Scott mentioned, you get credit for disaster preparedness. The bad news is, this final rule is a disaster. It is nothing short of a disaster. It went way beyond what they were supposed to do. If you look at the Treasury report in '18, April '18, it was supposed to be modernization for internet banks. They did that, but then they did seven other things that were unnecessary. The only good things in this, as Scott mentioned, for example, the CD list of what is required, what we get credit for. The advanced notice of preapproval for CD.

That was in the OCC rule, is all we needed was a tune up. Take the current regs, a tune up with some of the good ideas that we have. The 5% deposit rule, believe me, this could be done in 1,500 words, not 1,500 pages. And the community groups,

you know how they talk about, we had this theory in banking called regulation captive where the banks captured the regulators? No, no. In this case it was the community groups capturing the regulators because they got everything they wanted except the full treatment of race, which is not CRA. And what did they do? The three tests that we have, instead of lending investment services, and Senator Proxmire like that, they went with community development 50% and retail 50%.

No, it should be the three tests. Why? Because you as a banker decide where you want to make your loans. We're not going to allocate and tell you where, under the new one they're telling you 50% retail, 50% community development. Totally wrong. I did make a point. This is not interagency. This is a Fed rule. You've got the OCC and the FDIC. They're like, I used to play in a band. They're like cover bands for playing the Fed song. This is a Fed rule. Don't forget that. Very important. This is a Fed rule. The last slide I want to talk about here are the legal challenge. Why do we even talk about a legal challenge? We all believe in fair lending. We all believe in fair banking. That's why we're here. But there's also something in public policy called fair regulations. And if a regulation is unfair in terms of hurting your constituents, we are bankers. We have to report to our shareholders, no capital, no bank.

We have to meet our shareholder requirements. And also we have a legal requirement to meet the convenience and needs of our community. These regulations, this fair lending regulation that we have is fine. The CRA reg that we have is fine, but the new final rule is totally unfair. And it should be legally challenged like everything else. And guess what? The ABA and the BPI and their comments in August '22 made very clear that there is a good legal challenge argument, and I'm not a lawyer, but on the grounds of the statutory basis of CRA, the APA and even due process, why it should be challenged. Even the one person with common sense on the Federal Reserve who understands this happens to be a banker. Mickey Bowman. She dissented on this. And the two board members at the FDIC, they dissented, that's support for a legal challenge.

And there are many economic damages that could be easily provable here, not just in terms of the cost, the regulatory burden to the industry, but to the communities. What about the seven, 800 communities that would no longer have ISBs doing community development? And what about those large, the big cities like my home city of Miami, New York, L.A., Houston, Dallas, they supply all the money to the internet banks that go to those three states. That is unfair. That is totally unfair and should be challenged. And those are damages that can clearly be shown. And keep in mind, community groups challenge the OCC's rule. So why shouldn't banks do the same thing here? And a successful CRA challenge is very important why? What's on the mind of most bankers now? Of course, CRA. But no, the real thing is the buzzer rule, the capital rule. Now that's going to be challenged, we know that.

But let me tell you, in my opinion, to successfully challenge the capital rule, you're going to need to challenge the CRA rule. If you successfully challenge the CRA rule, and this will be done in the Fifth District in Dallas and Austin, the same place where we did the one in Texas where the CFPB was challenged. If we are successful in a challenge of CRA, then we will be successful I believe in a capital rule. But if we don't challenge CRA on the final rule, I don't see any way that there's going to be a good challenge on capital. They go hand in hand. You must challenge CRA to get a challenge on the capital rule. I've had a discussion in some of my articles. You'll see why I think that's important. If you believe as I do that this is unfair, contact ABA, BPI, CBA, let them know.

Especially if you're one of those courageous banks in Texas. And the Texas bankers, I give it to you absolutely for not being afraid to challenge your prudential regulators on this as you've been doing before with the CFPB. This must be challenged. I'll leave you with one final thought. People ask me a lot, what would Senator Proxmire think of this? Well, we don't know, but I will tell you one thing. He liked the current regs. He liked the three tests. Everything in them is fine. The rule is working fine now. It just needs to be tuned up with some of the good ideas that we got, and it needs to have the 5% reinvestment rule for modernization. That's all that was needed. We did not need an overhaul. We only needed a tune up with the 5% rule. With that in mind, I'm going to turn it back to the team here to close it out. Thank you.

Alan Kaplinsky:

Okay, well thank you very much Ken. Appreciate your being a guest once again on our program. And I'm just going to add to a postscript to what Ken said about a potential legal challenge. There are two cases pending before the U.S. Supreme Court. One of them is called the Raimondo case. R-A-I-M-O-N-D-O. And the other is called the Relentless case. It's got a peculiar name, but that is the name. They both deal, they are cases where the Supreme Court granted cert, and where oral argument will occur next month, on January 17th, there'll be a consolidated oral argument. The two cases involved the same set of facts

and the same legal issue. And one of the major issues upon which the Supreme Court granted cert is whether to overrule the Chevron judicial deference framework. Well, what is that framework, and why is that important here? Well, the Chevron judicial deference framework was created by the Supreme Court in a 1984 opinion involving, not surprisingly, Chevron.

And in that case, the Supreme Court held that if a statute is vague on something, or doesn't cover a particular thing, then the regulation promulgated by the agency charged with regulating under that particular statute must defer to the agency as long as the regulation is a reasonable interpretation of the statute. In other words, there's mandatory judicial deference. Supreme Court for years has not liked that doctrine or framework. They've chafed it. And in fact, in cases involving judicial deference, they always seem to find an alternative way of disposing of the case instead of citing the Chevron case, their own opinion. So there is, I would say, the conventional wisdom, and this is very unusual, but the conventional wisdom among academics who focus very much on administrative law is to the effect that the Supreme Court would not have granted cert in these two cases unless it was poised to overrule Chevron. And why is that important?

Well, that means if there is a legal challenge, and by the way, I agree completely with you Ken, that the place to bring a lawsuit if you're going to bring it, is in federal court in Texas, because any appeal will go to the Fifth Circuit Court of Appeals, which is a very conservative-minded court, and has already in at least one very recent case, namely the challenge to the constitutionality of the funding of the CFPB. Had no hesitation in finding the CFPB's funding mechanism to be unconstitutional. So the chances are pretty good, I think with a lawsuit brought there, may ultimately end up in the U.S. Supreme Court and you've got six to three margin of conservative judges to liberal justices, I should say.

So what will happen is if Chevron is thrown out the window, then the court is not required to say that the regulation is valid, if it's a reasonable interpretation, they will look at it themselves and they will look at the regulation as just an argument that's being made by the agency that if they agree with it, they can say it's good argument, but we're not required to follow it. If they don't like it, they can absolutely reject it out of hand. And any opinion that they come down with, which will probably be issued by the end of this term, which would be the end of June of next year, that will be controlling in any legal challenge that's made to CRA. So I thought I would, sorry for being a bit long-winded there, but I thought that was a very important point to make. I want to thank our speakers today, Scott Coleman and Sarah Dannecker, my colleagues at Ballard Spahr, and a very special thanks to Ken Thomas.

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